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Supreme Court of the United States

OCTOBER TERM, 1944

No. [redacted] 5

STATE OF NEW YORK AND SARATOGA SPRINGS COMMISSION AND SARATOGA SPRINGS AUTHORITY,

Petitioners,

v.

THE UNITED STATES OF AMERICA.

BRIEF FOR THE STATE OF NEW YORK, PETITIONER

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STATE OF NEW YORK AND SARATOGA SPRINGS COMMISSION AND SARATOGA SPRINGS AUTHORITY,

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v.

THE UNITED STATES OF AMERICA.

BRIEF FOR THE STATE OF NEW YORK, PETITIONER

Jurisdiction

Certiorari was granted by this Court on June 12, 1944, to review the judgments of the Circuit Court of Appeals for the Second Circuit and of the District Court herein.

Opinions Below

The opinion of the District Court (R. 22-26) is reported in 48 F. Supp. 15. The opinion of the Circuit Court of Appeals (R. 33-37) is reported in 140 F. (2d) 608.

Statement of the Case

This suit was brought by the United States in its District Court for the Northern District of New York against the State and its agencies for collection of tax in excess of $3,000 imposed by the United States upon sales of bottled mineral water by the State and its agencies. The State has defended upon the ground that it is selling a natural resource which it owns, incidentally to a larger program related to the health and welfare of its citizens, which has long been a matter of State concern, and that such sales are constitutionally immune from taxation.

The complaint (R. 2-6) was met by answers (R. 6-9) and the facts were stipulated (R. 9-21).

The decision of the District Court was for the United States upon the ground that the selling of Saratoga Springs mineral water was a 'business enterprise conducted for gain' (R. 22-26) and judgment was entered against the defendants, now petitioners (R. 27-30). Upon appeals (R. 30-31) the Circuit Court of Appeals affirmed, upon the ground that the claimed immunity was not justified by the test of 'necessity to protect the continued existence of a state' (R. 33-37).

The stipulation which occupies about twelve pages of the record (R. 9-21) is the best source for the facts, and the following is merely a general outline, with a few of the facts most immediately relevant.

Commencing in 1911, when the ancient springs at Saratoga had become greatly impaired under private operation, the State undertook the project of preserving and restoring them and making them of greatest public usefulness (R. 13). It has expended nearly $9,000,000 for lands and

improvements, of which $3,200,000 was borrowed by the Authority from the RFC, and has appropriated various other sums for current expenses and interest payments. The total annual operating receipts of the Commission and Authority have never been sufficient to meet annual expenses, even after excluding interest and amortization charges on the RFC loan (R. 20).

Of the numerous related activities which make up that aggregate deficit, the one producing the greatest net income is the lease of the Gideon Putnam Hotel-Sanitarium, and the two largest items of gross income, excepting appropriations by the Legislature, are from admissions to the bath houses and sales of the bottled waters (R. 21).

The gross receipts from sales of bottled waters averaged about $125,000 annually from 1932 to 1941 (R. 15), from which certain expenses including advertising (R. 16) were deducted, but not depreciation or other capital expenses, resulting in a profit which averaged slightly over $16,000 annually in those years (R. 18).

The consistent policy of the Commission and the Authority has been to increase the volume of waters bottled and sold and derive the largest profit possible from this activity, in order that the proceeds might be applied to the cost of other services rendered at the Spa (R. 17-18). The "profit" averaging over $16,000 annually, mentioned above, was thus applied (R. 19).

Three mineral waters and one plain water are bottled and sold, and were during the period covered by the assessments, all in their natural state. The mineral waters are Hathorn, a laxative water; Coesa, a diuretic water; and Geyser, a digestive water. These are properly classified as mineral waters; they are not suitable for indiscriminate

beverage use and cannot be mixed with fruit juices or alcoholic beverages. The plain water, known as State Seal, is of a high chemical and vegetable purity. It is used very largely in various state institutions and offices, and a small amount is also purchased by the general public, mostly on recommendation of physicians (R. 14). The waters of these springs have a recognized medical value, and are prescribed by physicians both for bathing and internal use (R. 12). About 50% of the total waters upon which the tax was levied were handled by one distributor in New York City and vicinity, but smaller amounts were sold elsewhere in New York State and in other states (R. 15).

Statutes Involved

The federal act directly involved is the Revenue Act of 1932, section 615 (a) (5), which is as follows:

> "There is hereby imposed * * * (5) upon all natural or artificial mineral waters or table waters, whether carbonated or not, and all imitations thereof, sold by the producer, bottler or importer thereof, in bottles or other closed containers, at over 12½ cents per gallon, a tax of 2 cents per gallon." (47 Stat. 265).

Paragraph 26 of the Stipulation of Facts (R. 21) lists several New York statutes relative to the Saratoga Springs reservation, of various years commencing with 1909. The following excerpts from Ch. 866 of N. Y. Laws of 1930 will serve as an illustration of their general purport:

> "A temporary state commission, to be known as the Saratoga Springs commission, is hereby created * * * for the purpose of ultimately developing the Saratoga Springs reservation as a state health resort and spa for use by the public for balneological, therapeutic and other similar healthful purposes. The development of such reservation for public health purposes is hereby declared a policy of the state * * *.

"The commission shall have the power and it shall be its duty, subject to the provisions of this act, to conserve, maintain, control and develop each and every part of the reservation property. * * * The commission may prescribe the terms upon which any excess of mineral water and gas not used on said reservation, or used under said leases or concessions, shall be sold or distributed, and shall prescribe the names, labels and advertisements to be affixed to the bottles or other vessels containing such waters, gases or other products, and may itself sell or dispose of the same. * * * The commission may make or cause to be made scientific studies and experiments concerning kinds of illnesses and diseases which lend themselves to the treatment of the mineral waters, products and facilities of the reservation, and shall exercise exclusive control and supervision over the manner and method of the use of the products and facilities of the reservation.

"The commission is hereby authorized and empowered to maintain and conduct the bath houses now on said reservation and such other bath houses as the commission may from time to time cause to be erected; to maintain and conduct the drink-hall or halls on said reservation and such others as may be built under the supervision of the commission; and also to maintain and conduct the bottling plant now on said reservation and is further authorized and empowered to enlarge or rebuild the same or construct a new and more adequate one as, in its discretion, will be most advantageous.

"The commission shall deposit at least once in each week in the depository or depositories designated by the [state] comptroller all moneys received by it for all purposes."

Specification of Error

The error asserted by the State against the decisions below is, of course, the fundamental error of having denied the tax immunity involved.

POINT I

The tax imposed is a direct burden upon a governmental function, and hence is constitutionally objectionable.

The principle of governmental immunity from taxation is sufficiently accepted as a principle, and sufficiently indefinite in its specific applications, so that the litigated cases tend to arise around the borders of the protected ground rather than squarely within its confines. As Mr. Justice Jackson observed in *United States* v. *Allegheny County*, 322 U. S. 174, 188: "Rarely does a state or municipality pursue the Federal Government itself." So it is in the present case that the facts do not present the problem with the utmost possible dramatic force; no claim will be made on behalf of the State that its existence will be terminated by the tax imposed. This concession is made at the beginning of argument, because the Circuit Court of Appeals seems to have regarded it as decisive, saying:

> "We think the fundamental consideration must be that exemption from federal taxation in a particular case flows from the necessity to protect the continued existence of a state." (R. 35-36).
>
> "For any lawful function of the federal government in the performance of which the United States acts directly is constitutionally immune from state taxation, unless Congress consents, whereas only a limited class of state activities are constitutionally immune from federal taxation." (R. 37).

Although not of itself a great threat to the existence of the State, it is submitted that the facts of the present case in no way fall short of a tax burden directly imposed upon the performance of a governmental function. Believing that the facts involve the principle of governmental immunity

and that the principle must be defended at its borders, the State has pressed the litigation to this Court.

A few citations will serve to trace the history of the principle sufficiently for present purposes.

The source of all discussion upon the reciprocal tax immunities inferred from the dual sovereignties of the Federal Constitution is the opinion of Chief Justice Marshall in *McCulloch* v. *Maryland*, 4 Wheat. 316 (1819), holding that a bank chartered by the United States was immune from a Maryland stamp tax imposed on the bank's circulating currency, and Mr. Justice Nelson's opinion in *Collector* v. *Day*, 11 Wall. 113 (1870), holding the salary of a Massachusetts judge immune from a federal income tax. In the latter case the basis of the inferred immunities was stated as follows:

> "It is admitted that there is no express provision in the Constitution that prohibits the general government from taxing the means and instrumentalities of the States, nor is there any prohibiting the States from taxing the means and instrumentalities of that government. In both cases the exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operation, if subject to the control of another and distinct government, can exist only at the mercy of that government. Of what avail are these means if another power may tax them at discretion?" (11 Wall. p. 127)

The decision of *Graves* v. *N. Y. ex rel. O'Keefe*, 306 U. S. 466 (1939), expressly overruled *Collector* v. *Day*, but not the doctrine of immunity of state property and activities from federal taxation. On the contrary, the majority opinion by Mr. Justice Stone in the O'Keefe case continued to speak of "the constitutional immunity of *either* government from taxation by the other" (306 U. S. p. 480, emphasis added), and said of *Helvering* v. *Gerhardt*,

304 U. S. 405 (1938), that it was properly held that the salaries of the employees of the Port of New York Authority were not immune, "even though the Authority be regarded as not subject to federal taxation" (p. 484). There was discussion of possible differences between state immunity and federal immunity (p. 485); the basis for overruling *Collector* v. *Day*, and similar decisions was said to be the unwarranted assumption that the tax burden placed upon another actually burdened the government by which he was employed or with which he dealt (pp. 483-486), and that case was overruled only to the extent made appropriate by that consideration (pp. 486-487). In the concurring opinion of Mr. Justice Frankfurter, also, it was only the "sterile refinements" (p. 488) and the "interdependent doctrine" (p. 492) which were condemned; the reason and force of the underlying doctrine was stated as follows:

> "Since two governments have authority within the same territory, neither through its power to tax can be allowed to cripple the operations of the other. Therefore state and federal governments must avoid exactions which discriminate against each other or obviously interfere with one another's operations." (p. 488.)

Likewise in *Mayo* v. *United States*, 319 U. S. 441, 447 (1943) Mr. Justice Reed said of the freedom of a federal activity from state taxation:

> "This freedom is inherent in sovereignty."

And in *United States* v. *Allegheny County*, 322 U. S. 174, 186 (1944), Mr. Justice Jackson said:

> "The trend of recent decisions has been to withdraw private property and profits from the shelter of governmental immunity but without impairing the immunity of the State or the Nation itself."

There remains, then, a doctrine of immunity of state property and activities from federal taxation, its essential vigor unimpaired, but its application very uncertainly defined.

For purposes of determining whether the present case is within the application of the principle, a significant decision is *Burnet* v. *Coronado Oil & Gas Co.*, 285 U. S. 393 (1931), invalidating a federal tax upon income of a lessee derived from oil produced from school lands, held in trust by the state and leased by it. The facts that a different result was reached in *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279 (1930) and that the *Coronado* case was distinguished in *Burnet v. Jergins Trust*, 288 U. S. 508, 516 (1932) and overruled in *Helvering* v. *Producers Corp.*, 303 U. S. 376, 383 (1938) do not affect the significance of those decisions as showing that the sale by a state of its natural resources (in those cases petroleum), even though continuously over a period of time, is a governmental function which would have been immune from any taxation had it been directly imposed upon the proceeds in the hands of the state. All those decisions turned, as did the *Gerhardt* and *O'Keefe* decisions, upon the fact that the taxation in question was not a direct burden upon the state activity involved, and still support the position of the present brief that the sale continuously by a state of its natural resources is a governmental activity entitled to immunity.

In the more recent decisions on tax immunity the favored test has been that of "*direct burden.*" Thus, in *Mayo* v. *United States*, it was said that the objectionable inspection fees "are laid *directly* upon the United States." (319 U. S. at p. 447, emphasis added.) In the *County of Allegheny* case all three opinions acknowledged the test, although Mr. Justice Roberts was of opinion that it was not being fol-

lowed. The brief for the United States in *Alabama* v. *King & Boozer*, 314 U. S. 1 (1941), disclaimed all tests for immunity except whether the tax was non-discriminatory and whether it was imposed upon the government or a private person. The opinion by the Chief Justice approved the test selected, and disagreed with the attorneys for the United States as to the incidence of the tax. The *O'Keefe* and *Gerhardt* cases certainly hold that income tax imposed upon salaries of employees is not a "direct burden" upon the employing government. The following statement from the *O'Keefe* opinion speaks for both:

> "The burden on government of a non-discriminatory income tax applied to the salary of the employee of a government or its instrumentality is the same, whether a state or national government is concerned." (306 U. S. at p. 485.)

In the present case it seems clear that the "direct burden" test is satisfied, and the United States does not argue the contrary. Instead, it passes that question by and relies upon the "governmental function" test, for which it cited in the courts below the *Gerhardt* case. See the comment of the District Court that the plaintiff, "finds particular comfort, if not the whole support for its position," in that case and three earlier ones (R. 25). The same cases are considered in the opinion of the Circuit Court of Appeals, leading to this statement:

> "We think the fundamental consideration must be that exemption from federal taxation in a particular case flows from the necessity to protect the continued existence of a state. Cf. *Helvering* v. *Gerhardt*, 304 U. S. 405, 421. The need of the state activity to maintain the states as they exist in our system of dual sovereignty will loom as the paramount issue, and whether any activity is described as essential or usual or traditional or something else will not weigh very heavily except as it bears upon that." (R. 35-36.)

A warning against all such tests is found in the majority opinion in *Brush* v. *Commissioner*, 300 U. S. 352, 361-364 (1937), and the double test of non-discrimination and direct burden is outlined in the dissent of Mr. Justice Roberts (p. 375). Mr. Justice Black has also criticized the test of "essential government functions" in his concurring opinion in the *Gerhardt* case, 304 U. S. at pp. 426-427. The doctrine that all activities of the federal government, including the bank involved in *McCulloch* v. *Maryland* and many more recent and novel businesses, are necessarily governmental, but identical activities of a state are proprietary, lacks a sense of reality. As Mr. Justice Black said, it is the people acting through Congress and the state legislatures who determine, as conditions demand, what services and functions the public welfare demands (304 U. S. p. 427).

Although the majority opinion in the *Gerhardt* case contained a lengthy discussion of the "nature" of the state activity involved—the Port of New York—it does not really support that test. Illustrative of its indefinite basis, is this *caveat* contained in the opinion:

> "Expressing no opinion whether a federal tax may be imposed upon the Port Authority itself with respect to its receipt of income or its other activities, we decide only that the present tax neither precludes nor threatens unreasonably to obstruct any function essential to the continued existence of the state government." (p. 424).

But when the *O'Keefe* case was decided ten months later, and the *Gerhardt* case was discussed in its opinion, there was no longer mention of the "nature" of the activities involved, but only of the incidence of the tax. See 306 U. S. p. 484.

The reason why the United States did not rely upon the "direct burden" test in the present case, although it as-

serted its superiority in the recent cases of *Mayo* and *King & Boozer*, is to be found in the nature of the present case.

If, as here, a tax is levied directly upon money in the hands of the State derived from its sale of its natural resources, little question remains about the incidence of the tax.

The State submits that it is the essence of sovereignty for a state to be able to dispose of its property. Possessed of such property, whether originally owned or acquired with time, the states as a traditional, usual and necessary practice have owned and disposed of this property. Land, water, oil, coal, gold, gravel in river beds, are but a few of the natural resources that the states have sold. Public welfare is subserved by making the resources of the state available for enjoyment by the people, and the proceeds from the sale of such property are revenue to carry on other governmental functions. If the states and federal government were to tax each other because of the ownership and sale of their respective natural resources, the burden upon government itself would be apparent.

Hence, it is not surprising that the courts have without question considered this governmental activity as one removed from the taxing power of the other sovereign. Thus, in *Group No. 1 Oil Corp.* v. *Bass*, 283 U. S. 279 (1930), where the Court sustained a federal tax upon profits derived by a lessee from the sale of oil and gas produced on lands leased by the State of Texas, the Court said (p. 282):

> "Property sold or otherwise disposed of by the government, either state or national, in order to raise revenue for government purposes, is in a broad sense a government instrumentality, with respect to which neither the property itself before sale, nor its sale by one government, may be taxed by the other."

More recently the Court reexamined the question of taxing the gains of lessees of state or federal lands in *Helvering v. Producers' Corporation*, 303 U. S. 376 (1938). The Court recognized the distinction between a tax upon the state and a tax upon the lessee when it framed the issue before it thus (p. 384):

> "whether in a case where a tax is not laid upon the *leases* as such, or upon the *government's property* or interest, but is imposed upon the gains of the lessee, like that laid upon others engaged in similar business enterprises, there is in truth such a direct and substantial interference with the performance of the government's obligation as to require immunity for the lessee's income." (Emphasis supplied.)

The State does not suppose that it is contended that the federal government may tax the income the states realize from leases of lands containing saleable natural resources. Is the state to be burdened because as a matter of state policy it is thought more desirable to dispose of these resources as a continuous state activity? Or conversely, if the federal government chose to produce and sell the oil on Indian lands, could a state tax the sale thereof or income produced thereby?

The case at bar presents such a situation. Involved here is a federal tax upon the sale by the State of its natural resources. The incidence of the tax is directly upon the State. Without reviewing all of the facts contained in the statement, the State points out that the sale of these natural waters by the petitioners is not an isolated activity, but merely a small part of a larger program of conservation of natural resources, promotion of health and creation of recreation facilities.

The distinction, therefore, between the case at bar and the cases cited by the District Court and the Circuit

Court of Appeals is readily apparent. In *South Carolina* v. *United States*, 199 U. S. 437; *Ohio* v. *Helvering*, 292 U. S. 360; *Helvering* v. *Powers*, 293 U. S. 214; and *Allen* v. *Regents*, 304 U. S. 439, the respective state was not engaged in the disposition of its natural resources. In the *South Carolina* and *Ohio* cases, the states bought and sold liquor; in the *Powers* case the state merely took over the management of an existing railway; in the *Regents* case the state constructed two stadia seating about 30,000 people each for universities whose student bodies were about 2,000 each, and sold admissions (304 U. S. p. 450). The facts in each of those cases are significant as to why an exception was made to the general principle of immunity of state activities from direct burdens.

The State points out that in the *South Carolina* case, the source of all adverse authorities, one of the most powerful considerations was the Court's fear that if the liquor business were free from federal taxation, the states might enter other businesses and thus destroy a large source of federal revenue. The three other cases cited against the State are to similar effect.

That consideration is certainly not present in the case at bar. If this Court should hold that the State may sell its natural mineral waters free from federal tax, there is no need to fear that the State may exercise its police powers in other fields of activity and thus limit the sources of federal revenue. The number of natural resources is not large and thus the list of immune activities rather limited. Furthermore, with respect to the particular facts of the case at bar, it is to be noticed that the State did not acquire the springs at Saratoga to bottle and sell the waters. In fact, although the first legislation creating the board

known as "The Commissioners of the State Reservation at Saratoga Springs" gave it the power to sell the excess of mineral water not used on the premises (L. 1909, ch. 569, Sec. 5), it was not until 1930 that the successors of this original board exercised that power.

It was urged by the United States herein that the absence of profits or the fact that profits from the sale of waters are used to defray the expenses of the Reservation will not immunize the sales. The State similarly contends that the fact that profits *are* realized from the sales does not *deprive* them of their immunity. As the Court said in *Brush* v. *Commissioner*, 300 U. S. 352, 372-373 (1936):

> "If that service be governmental it does not become private because a charge is made for it, or a profit realized. A state, for example, constructs and operates a highway. It may, if it choose, exact compensation for its use from those who travel over it (see *Bingham* v. *Golden Eagle Lines*, 297 U. S. 626, 628); but this does not destroy the claim that the maintenance of the highway is a public and governmental function. The state or the city may exact a tuition charge for instruction in the public schools; but thereby the maintenance of the public schools does not cease to be a function of the government. The state exacts a fee for issuing a license or granting a permit; for recording a deed; for rendering a variety of services in the judicial department. Do these various services thereby lose their character as governmental functions? The federal Post Office Department charges for its services; but no one would question the fact that its operation calls into exercise a governmental function."

Again, it is to be noticed that on the facts of the case at bar the sale of these natural waters is not an isolated activity, but is related to a particular program of conservation, health, and recreation. It is recognized that the Court, in *Allen* v. *Regents*, was not persuaded to exempt football tickets from a federal tax because the proceeds

of the exhibition were used to finance a state educational program. But in that case a state was merely the collecting agency for the tax which was payable by the purchaser of the ticket, whereas here the tax is against a state itself. Mention is made of the larger program at Saratoga Springs, however, because it is only in connection with that program that the State decided to sell these waters. Thus, to grant immunity in the case at bar does not necessarily require immunity when a state engages in a wholesale disposition of its natural resources, unrelated to any particular public program.

The State sees no reason why the taxing power of the federal government will be seriously impaired if the sale of Saratoga mineral waters is free from tax. On the other hand, to hold this activity within the scope of the federal taxing power might seriously hamper the operation of the program of conservation, health and recreation at the Spa.

Conclusion

Upon the foregoing argument it is respectfully submitted that the judgments below should be reversed and the complaint dismissed.

Albany, September 7, 1944.

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